

Financial statements and report of independent certified public accountants

State of Hawaii, Department of Health

June 30, 2003

March 31, 2004

Director of Health
State of Hawaii
Department of Health

Dear Madam:

This is our report on the financial audit of the Department of Health, State of Hawaii (Department) for the year ended June 30, 2003. Our audit was performed in accordance with the terms of our contract with the Department and with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of State and Local Governments, and Non-Profit Organizations* and the *Compliance Supplement for Single Audits of State and Local Governments*.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department's financial statements for the year ended June 30, 2003, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for State and local governments and non-profit organizations that receive federal financial assistance.

More specifically, the objectives of the audit were as follows:

1. To satisfy the audit requirements of OMB Circular A-133.
2. To provide a basis for an opinion on the fairness of the presentation of the Department's financial statements.
3. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the Department is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the Federal Government.
4. To determine whether the Department's internal control structure is adequate in assuring that there is effective control over and proper accounting of revenues, expenditures, assets, and liabilities, and to ensure that the Department has established sufficient controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.

Director of Health
Department of Health
State of Hawaii
March 31, 2004

5. To determine whether the Department has with laws and regulations that may have a material effect on the combined financial statements and on each major federal financial assistance program of the Department.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants and *Government Auditing Standards*, issued by the Comptroller General of the United States. The scope of our audit included an examination of the transactions and accounting records of the Department for the year ended June 30, 2003. In addition, we reviewed the existing internal control structure to provide us with a basis to report whether the Department had complied with the material terms and conditions of federal grant agreements.

ORGANIZATION OF THE REPORT

This report is presented in four parts as follows:

- Part I – The financial statements of the Department for the year ended June 30, 2003 and our opinion on the financial statements.
- Part II – Our reports on compliance and internal control.
- Part III – Schedule of findings and questioned costs.
- Part IV – Response of the affected agency.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the Department of Health, State of Hawaii.

Very truly yours,



C O N T E N T S

	Page
PART I – FINANCIAL SECTION	
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS	5
BASIC FINANCIAL STATEMENTS	
GOVERNMENT-WIDE FINANCIAL STATEMENTS	
STATEMENT OF NET ASSETS	7
STATEMENT OF ACTIVITIES	8
GOVERNMENTAL FUND FINANCIAL STATEMENTS	
BALANCE SHEET	9
RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE TO THE STATEMENT OF NET ASSETS	10
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES	11
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES	12
PROPRIETARY FUND FINANCIAL STATEMENTS	
STATEMENT OF NET ASSETS	13
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS	14
STATEMENT OF CASH FLOWS	15
FIDUCIARY FUND FINANCIAL STATEMENTS	
STATEMENT OF FIDUCIARY NET ASSETS	16
NOTES TO FINANCIAL STATEMENTS	18
REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN MANAGEMENT’S DISCUSSION AND ANALYSIS	
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND	34
BUDGETARY COMPARISON SCHEDULE – TOBACCO SETTLEMENT FUND	35
BUDGETARY COMPARISON SCHEDULE – BUDGET-TO-GAAP RECONCILIATION	36
SUPPLEMENTARY INFORMATION	
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON SUPPLEMENTARY INFORMATION	38
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	39
PART II – REPORTS ON COMPLIANCE AND INTERNAL CONTROL	49
PART III – SCHEDULE OF FINDINGS AND QUESTIONED COSTS	54
PART IV – RESPONSE OF THE AFFECTED AGENCY (provided by Department of Health, State of Hawaii)	60
PART V – COMMENTS REGARDING PRIOR FISCAL YEAR FINDINGS (provided by Department of Health, State of Hawaii)	67

PART I
FINANCIAL SECTION

Report of Independent Certified Public Accountants

Director of Health
Department of Health
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Department of Health, State of Hawaii (Department) as of and for the year ended June 30, 2003, which collectively comprise the Department's basic financial statements as listed in the contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note A, the financial statements of the Department of Health, State of Hawaii, are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2003, and the changes in its financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information for the Department of Health, State of Hawaii, as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Director of Health
Department of Health
State of Hawaii

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2004 on our consideration of the Department of Health, State of Hawaii's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The budgetary comparison schedules on pages 34 to 36 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The Department of Health, State of Hawaii, has not presented Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

A handwritten signature in black ink, appearing to read "Grant Thornton LLP", is positioned above the date and location.

Honolulu, Hawaii
February 26, 2004

State of Hawaii
Department of Health

STATEMENT OF NET ASSETS

June 30, 2003

ASSETS	Primary Government		
	Governmental Activities	Business-type Activities	Total
CURRENT ASSETS			
Cash and cash equivalents on deposit with the State of Hawaii	\$ 120,590,696	\$ 100,202,725	\$ 220,793,421
Receivables			
Accrued interest and loan fee	47,590	2,261,687	2,309,277
Due from Federal government	2,561,952	851,517	3,413,469
Internal balances	(395,000)	395,000	-
Current maturities of loans receivables	-	11,233,023	11,233,023
	<u>2,214,542</u>	<u>14,741,227</u>	<u>16,955,769</u>
Total current assets	122,805,238	114,943,952	237,749,190
LOANS RECEIVABLE, net of current maturities	-	162,446,453	162,446,453
CAPITAL ASSETS (net of accumulated depreciation) (notes A and D)	<u>72,889,696</u>	<u>351,549</u>	<u>73,241,245</u>
TOTAL ASSETS	<u>\$ 195,694,934</u>	<u>\$ 277,741,954</u>	<u>\$ 473,436,888</u>
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Vouchers and contracts payable	\$ 11,650,441	\$ -	\$ 11,650,441
Accrued wages and employee benefits payable	13,110,899	49,082	13,159,981
Workers' compensation liability	634,373	-	634,373
Deferred income	330,814	-	330,814
Due to other funds	46,805	-	46,805
Total current liabilities	25,773,332	49,082	25,822,414
ACCRUED VACATION	11,842,316	-	11,842,316
COMMITMENTS AND CONTINGENCIES (notes F and G)	-	-	-
NET ASSETS			
Investment in capital assets	72,889,696	351,549	73,241,245
Restricted for:			
Loans	-	277,341,323	277,341,323
Tobacco prevention and control	27,277,052	-	27,277,052
Capital projects	1,406,017	-	1,406,017
Other purposes	32,419,213	-	32,419,213
Unrestricted	24,087,308	-	24,087,308
	<u>158,079,286</u>	<u>277,692,872</u>	<u>435,772,158</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 195,694,934</u>	<u>\$ 277,741,954</u>	<u>\$ 473,436,888</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF ACTIVITIES

Year ended June 30, 2003

Functions/Programs	Expenses	Program revenues		Net (expense) revenue and changes in net assets		
		Charges for Services	Operating Grants and Contributions	Primary Government		
				Governmental Activities	Business-type Activities	Total
Primary government						
Governmental Activities						
General administration	\$ 24,935,698	\$ 325,164	\$ 8,638,481	\$ (15,972,053)	\$ -	\$ (15,972,053)
Environmental health administration	36,287,269	5,893,051	8,388,703	(22,005,515)	-	(22,005,515)
Behavioral health services administration	192,769,198	1,973,307	13,136,150	(177,659,741)	-	(177,659,741)
Health resources administration	249,905,904	1,275,123	56,895,824	(191,734,957)	-	(191,734,957)
Total governmental activities	503,898,069	9,466,645	87,059,158	(407,372,266)	-	(407,372,266)
Business-type activities						
Environmental health loan programs	2,028,675	5,938,729	10,310,356	-	14,220,410	14,220,410
Total business-type activities	2,028,675	5,938,729	10,310,356	-	14,220,410	14,220,410
Total primary government	<u>\$ 505,926,744</u>	<u>\$ 15,405,374</u>	<u>\$ 97,369,514</u>	(407,372,266)	14,220,410	(393,151,856)
General revenues						
State general fund allotments				317,485,335	-	317,485,335
Nonimposed employee fringe benefits				30,535,685	-	30,535,685
Environmental response tax				1,562,115	-	1,562,115
Deposit beverage container fee				2,091,733	-	2,091,733
Advance glass disposal fee				3,066,777	-	3,066,777
Tobacco settlement funds				43,523,519	-	43,523,519
Transfers				(21,744,942)	3,645,000	(18,099,942)
Total general revenues and transfers				376,520,222	3,645,000	380,165,222
Change in net assets				(30,852,044)	17,865,410	(12,986,634)
Net assets at July 1, 2002				188,931,330	259,827,462	448,758,792
Net assets at June 30, 2003				<u>\$ 158,079,286</u>	<u>\$ 277,692,872</u>	<u>\$ 435,772,158</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

GOVERNMENTAL FUNDS
BALANCE SHEET

June 30, 2003

ASSETS	General	Tobacco Settlement	Other Funds	Total Governmental
Cash and cash equivalents	\$ 48,206,306	\$ 28,033,175	\$ 44,351,215	\$ 120,590,696
Accrued interest receivable	-	-	47,590	47,590
Due from Federal government	-	-	2,561,952	2,561,952
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
TOTAL ASSETS	<u>\$ 48,206,306</u>	<u>\$ 28,033,175</u>	<u>\$ 46,960,757</u>	<u>\$ 123,200,238</u>
LIABILITIES AND FUND BALANCES				
Liabilities				
Vouchers and contracts payable	\$ 7,867,732	\$ 708,048	\$ 3,074,661	\$ 11,650,441
Accrued wages and employee benefits	4,874,110	48,075	1,527,411	6,449,596
Deferred income	-	-	330,814	330,814
Due to State of Hawaii	46,805	-	395,000	441,805
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities	12,788,647	756,123	5,327,886	18,872,656
Fund Balances				
Reserved for encumbrance	39,492,554	10,455,938	28,255,839	78,204,331
Unreserved	(4,074,895)	16,821,114	13,377,032	26,123,251
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total fund balances	35,417,659	27,277,052	41,632,871	104,327,582
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 48,206,306</u>	<u>\$ 28,033,175</u>	<u>\$ 46,960,757</u>	<u>\$ 123,200,238</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE TO THE
STATEMENT OF NET ASSETS

June 30, 2003

Total fund balance - governmental funds	\$ 104,327,582
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore not reported in the funds.	72,889,696
Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds.	(18,503,619)
Workers' compensation liability reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds.	<u>(634,373)</u>
Net assets of governmental activities	<u><u>\$ 158,079,286</u></u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

Year ended June 30, 2003

	General	Tobacco Settlement	Other Funds	Total Governmental
Revenues				
State allotments, net	\$ 311,743,598	\$ -	\$ 5,741,737	\$ 317,485,335
Intergovernmental	-	-	84,623,804	84,623,804
Tobacco settlement	-	43,523,519	-	43,523,519
Non-imposed employee fringe benefits	30,535,684	-	-	30,535,684
Taxes, fees, fines and other	-	-	16,886,968	16,886,968
Interest income	-	869,904	949,333	1,819,237
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	342,279,282	44,393,423	108,201,842	494,874,547
Expenditures				
General administration	17,649,884	-	6,971,884	24,621,768
Environmental health	20,035,354	-	14,398,930	34,434,284
Behavioral health services	172,815,777	-	17,792,186	190,607,963
Health resources	154,713,111	32,207,043	62,323,666	249,243,820
	<hr/>	<hr/>	<hr/>	<hr/>
Total expenditures	365,214,126	32,207,043	101,486,666	498,907,835
Deficiency of revenues over expenditures	(22,934,844)	12,186,380	6,715,176	(4,033,288)
Other financing sources (uses)				
Transfers in	-	-	6,682,711	6,682,711
Transfers out	-	(18,722,949)	(9,799,541)	(28,522,490)
	<hr/>	<hr/>	<hr/>	<hr/>
Total other financing sources (uses)	-	(18,722,949)	(3,116,830)	(21,839,779)
Net change in fund balances	(22,934,844)	(6,536,569)	3,598,346	(25,873,067)
Fund Balances at July 1, 2002	58,352,503	33,813,621	38,034,525	130,200,649
	<hr/>	<hr/>	<hr/>	<hr/>
Fund Balances at June 30, 2003	\$ 35,417,659	\$ 27,277,052	\$ 41,632,871	\$ 104,327,582
	<hr/>	<hr/>	<hr/>	<hr/>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES

Year ended June 30, 2003

Net change in fund balances - total governmental funds \$ (25,873,067)

Amounts reported for governmental activities in the statement of activities
are different because:

Governmental funds report capital outlays as expenditures. However
in the statement of activities the cost of those assets is allocated
over their estimated useful lives and reported as depreciation expense.
This is the amount by which depreciation exceeded capital outlays
for the year. (3,693,038)

Compensated absences reported in the statement of activities
do not require the use of current financial resources and therefore are
not reported as expenditures in governmental funds. (651,566)

Workers' compensation liability reported in the statement of activities
do not require the use of current financial resources and therefore are
not reported as expenditures in governmental funds. (634,373)

Change in net assets of governmental activities \$ (30,852,044)

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF NET ASSETS – PROPRIETARY FUNDS

June 30, 2003

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
ASSETS			
Current assets			
Cash and cash equivalents			
in State Treasury	\$ 89,528,990	\$ 10,673,735	\$ 100,202,725
Loan fees receivable	566,544	74,030	640,574
Accrued interest receivable	1,588,748	32,365	1,621,113
Due from other funds	-	395,000	395,000
Due from federal government	400,076	451,441	851,517
Current portion of loans receivable	10,659,371	573,652	11,233,023
	<hr/>	<hr/>	<hr/>
Total current assets	102,743,729	12,200,223	114,943,952
Loans receivable, net of current portion	151,795,915	10,650,538	162,446,453
Property and equipment, net of accumulated depreciation, at cost	19,961	331,588	351,549
	<hr/>	<hr/>	<hr/>
TOTAL ASSETS	<u>\$ 254,559,605</u>	<u>\$ 23,182,349</u>	<u>\$ 277,741,954</u>
LIABILITIES			
Current liabilities			
Accrued payroll and other	\$ 41,343	\$ 7,739	\$ 49,082
	<hr/>	<hr/>	<hr/>
Total liabilities	41,343	7,739	49,082
NET ASSETS			
Invested in capital assets	19,961	331,588	351,549
Restricted	254,498,301	22,843,022	277,341,323
	<hr/>	<hr/>	<hr/>
Total net assets	254,518,262	23,174,610	277,692,872
	<hr/>	<hr/>	<hr/>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 254,559,605</u>	<u>\$ 23,182,349</u>	<u>\$ 277,741,954</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS –
PROPRIETARY FUND

Year ended June 30, 2003

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Operating revenues			
Interest income from loans	\$ 3,956,751	\$ 158,727	\$ 4,115,478
Administration loan fee	1,451,773	371,478	1,823,251
	<hr/>	<hr/>	<hr/>
Total revenues	5,408,524	530,205	5,938,729
Expenses			
Administrative	1,202,434	272,850	1,475,284
State program management	-	208,956	208,956
Small systems	-	1,858	1,858
Water protection	-	342,577	342,577
	<hr/>	<hr/>	<hr/>
Total expenses	1,202,434	826,241	2,028,675
	<hr/>	<hr/>	<hr/>
Operating income	4,206,090	(296,036)	3,910,054
Nonoperating revenues			
Interest income from investments	2,535,929	239,321	2,775,250
Federal contribution	4,428,893	3,105,208	7,534,101
State contribution	2,094,000	1,551,000	3,645,000
Other	685	320	1,005
	<hr/>	<hr/>	<hr/>
Total nonoperating revenues	9,059,507	4,895,849	13,955,356
	<hr/>	<hr/>	<hr/>
CHANGE IN NET ASSETS	13,265,597	4,599,813	17,865,410
Net assets at July 1, 2002	241,252,665	18,574,797	259,827,462
	<hr/>	<hr/>	<hr/>
Net assets at June 30, 2003	<u>\$ 254,518,262</u>	<u>\$ 23,174,610</u>	<u>\$ 277,692,872</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF CASH FLOWS – PROPRIETARY FUND

Year ended June 30, 2003

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Cash flows from operating activities:			
Interest income from loans	\$ 3,865,871	\$ 143,010	\$ 4,008,881
Administrative loan fees	1,387,937	309,791	1,697,728
Principal repayments on loans	9,687,830	473,601	10,161,431
Disbursement of loan proceeds	(11,279,754)	(2,202,868)	(13,482,622)
Payment to employees	(837,081)	(228,813)	(1,065,894)
Payments to vendors	(345,779)	(535,179)	(880,958)
Net cash flows provided by (used in) operating activities	2,479,024	(2,040,458)	438,566
Cash flows from noncapital financing activities:			
Federal contributions	4,028,817	3,182,157	7,210,974
State contributions	2,094,000	1,551,000	3,645,000
Transfer to other funds	-	(255,013)	(255,013)
Net cash flows provided by noncapital financing activities	6,122,817	4,478,144	10,600,961
Cash flows from capital and related financing activities:			
Purchase of equipment	(26,002)	(153,741)	(179,743)
Net cash flows used in capital and related financing activities	(26,002)	(153,741)	(179,743)
Cash flows from investing activities:			
Interest from investments	3,016,363	285,281	3,301,644
Net cash flows provided by investing activities	3,016,363	285,281	3,301,644
NET INCREASE IN CASH	11,592,202	2,569,226	14,161,428
Cash balance at July 1, 2002	77,936,788	8,104,509	86,041,297
Cash balance at June 30, 2003	\$ 89,528,990	\$ 10,673,735	\$ 100,202,725

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF CASH FLOWS – PROPRIETARY FUND (continued)

Year ended June 30, 2003

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
	<u> </u>	<u> </u>	<u> </u>
Reconciliation of operating income to net cash provided by (used in) operating activities:			
Operating income	\$ 4,206,090	\$ (296,036)	\$ 3,910,054
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation expense	11,294	62,140	73,434
Change in assets and liabilities:			
Loan receivables	(1,591,924)	(1,729,267)	(3,321,191)
Accrued interest on loans receivables	(90,880)	(15,716)	(106,596)
Loan fees receivable	(63,836)	(61,688)	(125,524)
Accrued wages and other	8,280	109	8,389
	<u> </u>	<u> </u>	<u> </u>
Net cash provided by (used in) operating activities	<u><u>\$ 2,479,024</u></u>	<u><u>\$ (2,040,458)</u></u>	<u><u>\$ 438,566</u></u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS

June 30, 2003

ASSETS

Cash and cash equivalents	
On deposit with banks and on hand	<u>\$ 311,900</u>
TOTAL ASSETS	<u><u>\$ 311,900</u></u>

LIABILITIES

Due to others	<u>\$ 311,900</u>
TOTAL LIABILITIES	<u><u>\$ 311,900</u></u>
Net assets	<u><u>\$ -</u></u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Introduction

The Department of Health (Department), State of Hawaii (State), administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment and the enforcement of environmental health laws. Federal grants received to support the State's health services and programs are administered by the Department.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments. This Statement established new financial reporting requirements for state and local governments in the United States of America. They require new information and restructure much of the information that governments have presented in the past. Comparability with reports issued in years prior to 2002 is affected. The Department was required to implement these standards for the fiscal year ended June 20, 2002.

Other GASB Statements were required to be implemented in conjunction with Statement 34. Therefore, the Department implemented the following GASB Statements: Statement 36, Recipient Reporting for Certain Shared Nonexchange Revenues, Statement 37, Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments: Omnibus Statement 38, Certain Financial Statement Note Disclosures and Statement 41, Budgetary Comparison Schedules – Perspective Differences.

The Department is part of the executive branch of the State. The financial statements of the Department of Health, State of Hawaii, are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2003, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2. Reporting Entity

The Department has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Department are such that exclusion would cause the Department's financial statements to be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. The Department has determined, based on the GASB criteria, that it has no component units.

3. Government-Wide and Fund Financial Statements

The government-wide financial statements, the statement of net assets and the statement of activities, report information of all of the nonfiduciary activities of the Department. Governmental activities, which normally are supported by State allotments and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds, proprietary funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Measurement Focus, Basis of Accounting and Financial Statement Presentation

Government-wide financial statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include federal grants and interest on investments. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with generally accepted accounting principles since they have been earned and are expected to be collected within sixty days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the Department.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation which is recorded as an expenditure when utilized or paid (note A9).

Proprietary Funds and Fiduciary Funds – The financial statements of proprietary funds and fiduciary funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

Each proprietary fund has the option under GASB Statement 20, Accounting and Financial Reporting for Proprietary funds and Other Governmental Entities that Use Proprietary Fund Accounting, to elect to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The Department's two enterprise funds have elected to not apply FASB statements after the applicable date.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Measurement Focus, Basis of Accounting and Financial Statement Presentation (continued)

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Department's enterprise funds are interest income and administrative loan fees on loans made to county governments. Federal grants, State matching funds and interest income from investments are reported as nonoperating income.

5. Fund Accounting

The financial activities of the Department are recorded in individual funds, each of which is deemed to be a separate accounting entity. The Department uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

a. Governmental funds

General fund – The general fund is the general operating fund of the Department. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

Special revenue funds – Special revenue funds are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specified purposes.

Capital projects fund – Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary fund type).

b. Proprietary funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to customers, or where sound financial management dictates that periodic determinations of results of operations are appropriate.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Fund Accounting (continued)

c. Fiduciary funds

The Department presents as fiduciary funds those activities that account for assets held in a trustee capacity or as an agent for individuals, private organizations, or other governmental units.

d. Major funds

The Department reports the following major governmental funds:

General Fund

Hawaii Tobacco Settlement Special Fund – accounts for all tobacco settlement monies and interest and earnings accruing from the investment of such moneys.

The Department reports the following major proprietary funds:

Water Pollution Control Revolving Fund – accounts for federal and state funds used to provide loans in perpetuity to county and state agencies for the construction of wastewater treatment facilities and the repayment, interest and earnings from such loans and the investment of such moneys.

Drinking Water Treatment Revolving Loan Fund – accounts for federal and state funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and the repayment, interest and earnings from such loans and the investment of such moneys.

6. Capital Assets

Capital assets, which includes property and equipment, are reported in the applicable governmental or business-type activities in the government-wide financial statements. Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

Land	All capitalized
Land improvements	\$100,000
Building and building improvements	100,000
Equipment	5,000

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6. Capital Assets (continued)

Purchased and constructed capital assets are valued at cost. Donated assets are recorded at their fair market value at the date of donation.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements.

Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds financial statements. The Department utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. Generally, the useful lives are as follows:

	<u>Governmental- type activities</u>	<u>Proprietary fund and business- type activities</u>
Land improvements	15	Not applicable
Building and building improvements	30	Not applicable
Furniture and equipment	5 – 7	5 – 7

7. Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with original maturities of three months or less. It also includes amounts held in the State Treasury. The State Director of Finance is responsible for safekeeping of all moneys paid into the State Treasury (cash pool). The Director of Finance may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that the depository banks pledge, as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

Investments can be categorized to give an indication of the level of risk assumed by the Department. Category 1 includes investments that are insured or for repurchase agreements,

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Cash and Cash Equivalents (continued)

collateralized by underlying securities that are so held. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker-dealer in the Department's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker-dealer but not in the Department's name.

Since all of the Department's cash is included in the State cash pool, the category of risk is not determinable at the Department level.

8. Deferred Revenues

Deferred revenues at the fund level and government-wide level arise when the Department receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the Department has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and revenue is recognized. Deferred revenues at June 30, 2003 consists primarily of Federal grant funds.

9. Compensated Absences

Employees hired on or before July 1, 2001 earn vacation at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn vacation at rates ranging between 1 and 2 working days for each month of service, depending upon the employee's years of service and job classification. Vacation days may be accumulated to a maximum of 90 days. Employees are entitled to receive cash payment for accumulated vacation upon termination. Accumulated vacation is not reported in the governmental fund financial statements as that amount is not expected to be paid with current funds. The government-wide financial statements present the cost of accumulated unpaid vacation as a liability. A reconciliation of changes in aggregate liabilities for accumulated vacation is as follows:

Balance at July 1, 2002	\$17,852,053
Net change	<u>651,566</u>
Balance at June 30, 2003	18,503,619
Less current portion	<u>6,661,303</u>
	<u><u>\$11,842,316</u></u>

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

9. Compensated Absences (continued)

Employees hired on or before July 1, 2001 also earn sick leave credits at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn sick leave credits at the rate of one and one-quarter or one and three-quarters working days for each month of service, depending upon the employee's years of service and job classification. Sick leave credits may be accumulated without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a Department employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii. Accumulated sick leave as of June 30, 2003 relating to the Department approximated \$57,262,622.

10. Insurance

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State General Fund.

Under the provisions of GASB Statement No. 10, liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees), are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

During the year ended June 30, 2003, the Department was covered by the State's self-insured workers' compensation program for medical expenses of the injured Department employees. However, the Department was required to pay Temporary Total Disability (TTD) and Temporary Partial Disability (TPD) benefits for employees on the Department's payroll. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

10. Insurance (continued)

The Department paid \$679,000 for workers' compensation claims during the year. A reconciliation of changes in workers' compensation liability is as follows:

<u>Balance at July 1, 2002</u>	<u>Net change</u>	<u>Balance at June 30, 2003</u>
\$ –	\$634,373	\$634,373

11. Transfers

Transfers are used to move revenues from the fund that statutes require to collect them to the fund that statute requires to expend them. The government-wide statement of activities eliminates transfers within the segregated governmental and business-type activities. Only transfers between the two columns appear in this statement.

12. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

13. Non-imposed Employee Fringe Benefits

Payroll fringe benefit costs of the Department's employees funded by general fund appropriations are assumed by the State and are not charged to the Department's operating funds. These costs, totaling \$30,535,685, of which \$7,334,000 was for retirement benefits, have been reported as revenues and expenditures in the Department's financial statements for the fiscal year ended June 30, 2003.

Payroll fringe benefit costs related to federally funded salaries are not assumed by the State and are recorded as expenditures in the Department's financial statements.

NOTE B – BUDGETING AND BUDGETARY CONTROL

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in the State Constitution, the Hawaii

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE B – BUDGETING AND BUDGETARY CONTROL (continued)

Revised Statutes and other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii. To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP). Encumbrances represent executed but unperformed purchase orders or contracts. In the accompanying financial statements, encumbrances are recorded as expenditures for budgetary purposes and as reservations of fund balance for GAAP purposes. Since budgetary basis differs from GAAP, budget and actual amounts in the accompanying Required Supplementary Information – Budgetary Schedules are presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures and other financing sources (uses) on a budgetary basis at June 30, 2003, to revenues in excess of (less than) expenditures and other financing sources (uses) presented in conformity with GAAP is set forth in the Notes to the Required Supplementary Information.

NOTE C – LOANS RECEIVABLE

At June 30, 2003, the proprietary fund loans receivable consists of loans to county governmental units for the water pollution control and drinking water treatment programs. The loans are due in annual, semi-annual or quarterly payments, including interest at 1.55% to 3.02%, commencing not later than one year after project completion or notice to proceed. Final payment is due not later than twenty years after project completion. Accrued interest receivable on the loans amounted to approximately \$1,555,825 at June 30, 2003.

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2003:

Year ending June 30,	
2004	\$ 11,233,023
2005	11,525,840
2006	11,807,261
2007	12,098,068
2008	12,396,571
Thereafter	<u>114,618,713</u>
	<u><u>\$173,679,476</u></u>

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE D – CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003 was as follows:

	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
Governmental activities:				
Capital assets, not being depreciated				
Land	<u>\$ 1,018,080</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,018,080</u>
Total capital assets not being depreciated	1,018,080	—	—	1,018,080
Capital assets, being depreciated				
Land Improvements	1,862,927	—	—	1,862,927
Building and improvements	126,113,479	—	(276,000)	125,837,479
Furniture and equipment	<u>12,298,031</u>	<u>930,456</u>	<u>(1,029,979)</u>	<u>12,198,508</u>
Total capital assets being depreciated	140,274,437	930,456	(1,305,979)	139,898,914
Less accumulated depreciation				
Land Improvements	1,475,755	115,023	—	1,590,778
Building and improvements	52,718,719	3,892,465	(276,000)	56,335,184
Furniture and equipment	<u>10,515,309</u>	<u>598,997</u>	<u>(1,012,970)</u>	<u>10,101,336</u>
Total accumulated depreciation	<u>64,709,783</u>	<u>4,606,485</u>	<u>(1,288,970)</u>	<u>68,027,298</u>
Governmental activities, net	<u>\$ 76,582,734</u>	<u>\$(3,676,029)</u>	<u>\$ 17,009</u>	<u>\$ 72,889,696</u>
Business-type activities:				
Capital assets being depreciated				
Equipment	<u>\$ 459,907</u>	<u>\$ 179,743</u>	<u>\$ (46,188)</u>	<u>\$ 593,462</u>
Total capital assets being depreciated	459,907	179,743	—	593,462
Less accumulated depreciation for:				
Equipment	<u>214,667</u>	<u>73,434</u>	<u>(46,188)</u>	<u>241,913</u>
Total accumulated depreciation	<u>214,667</u>	<u>73,434</u>	<u>(46,188)</u>	<u>241,913</u>
Business-type activities capital assets, net	<u>\$ 245,240</u>	<u>\$ 106,309</u>	<u>\$ —</u>	<u>\$ 351,549</u>

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE D – CAPITAL ASSETS (continued)

Current period depreciation expense was charged to function as follows:

Governmental activities:	
General administration	\$ 513,091
Environmental health	1,632,877
Behavioral health	1,598,868
Health resources	<u>861,649</u>
Total depreciation expense – governmental activities	<u><u>\$4,606,485</u></u>
Business-type activities:	
Environmental health	<u>\$ 73,434</u>
Total depreciation expense – business-type activities	<u><u>\$ 73,434</u></u>

NOTE E – RETIREMENT BENEFITS

1. Employees' Retirement System

Plan Description

All eligible employees of the State are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for ERS. That report may be obtained from them.

The ERS consists of a contributory plan and a noncontributory plan. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service excluding the payment of salary in lieu of vacation. Vesting requirements for the contributory and noncontributory plans are five years and ten years, respectively. All contributions, benefits and eligibility requirements are governed by Chapter 88.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE E – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

Funding Policy

Most covered employees of the contributory plan are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of the prosecuting attorney and the attorney general, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The actuarial cost or funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contributions to the ERS is comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029.

The contribution requirement for all employers as of June 30, 2003, 2002, 2001, 2000, and 1999 were approximately \$191 million (100% contributed), \$167 million (100% contributed), \$164 million (5% contributed), and \$172 million (13% contributed), and \$185 million (83% contributed), respectively.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all employees hired prior to July 1, 1996 who retire from State employment on or after attaining age 62 with at least ten years of service or age 55 with at least thirty years of service under the noncontributory plan and age 55 with at least five years of service under the contributory plan. Retirees credited with at least ten years of service excluding sick leave credit qualify for free medical insurance premiums; however, retirees with less than ten years must assume a portion of the monthly premiums. All service-connected disability retirees who retired after June 30, 1984, with less than ten years of service also qualify for free medical insurance premiums. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement of a portion of the basic medical coverage premiums.

For employees hired after July 1, 1996 and retire with fewer than twenty-five years of service, the State shall pay to a fund a monthly contribution equal to one-half of the retired employee's monthly Medicare or non-Medicare premium for certain medical benefits for retired employees with ten or more years of service; and seventy-five percent of the retired employee's monthly Medicare or non-Medicare premium for retired employees with at least fifteen but fewer than twenty-five years of service.

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE E – RETIREMENT BENEFITS (continued)

2. Post-Retirement Health Care and Life Insurance Benefits (continued)

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued.

3. Cost of Retirement Benefits

The Department's general fund share of the expense for pension and post-retirement benefits for the year ended June 30, 2003 are paid from the State General Fund and approximate \$7,334,000 (note A13). The Department's special revenue fund and proprietary fund share of the pension and post-retirement benefits expense for the year ended June 30, 2003 was approximately \$3,138,000 and \$212,000, respectively, and are included in the Department's financial statements.

NOTE F – LEASE OBLIGATIONS

The Department leases various office facilities and equipment on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rentals on noncancelable operating leases at June 30, 2003:

	<u>Amount</u>
Year ending June 30,	
2004	\$ 930,870
2005	852,080
2006	949,790
2007	444,680
2008	418,340
	<u>\$3,595,760</u>

Total rent expense for 2003 reflected in the general and special revenue funds was \$1,897,390.

NOTE G – COMMITMENTS AND CONTINGENCIES

1. Deferred Compensation

In 1983, the State established a deferred compensation plan, which enables State employees to defer a portion of their compensation. The State Department of Human Resources Development has the

State of Hawaii
Department of Health

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2003

NOTE G – COMMITMENTS AND CONTINGENCIES (continued)

1. Deferred Compensation (continued)

fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant.

2. Litigation

The Department is a party to various legal proceedings, most of which normally occur in governmental operations. Although the Department and its counsel are unable to express opinions as to the outcome of the litigation, it is their opinion that any potential liability arising therefrom, will not have a material adverse effect on the financial position of the Department because any judgments against the Department are judgments against the State and would have to be paid by legislative appropriation of the State General Fund and not by the Department.

3. Ceded Land

The Office of Hawaiian Affairs (OHA) and the State of Hawaii are presently in litigation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. As of June 30, 2003, the outcome of the lawsuit had not been decided.

NOTE H – RELATED PARTY TRANSACTIONS

For the year ended June 30, 2003, the following funds were transferred from the Department to the:

State General Fund	\$ 7,469,072
Department of Budget & Finance	10,648,532
Department of Human Services	6,259,886
Department of Land & Natural Resources	500,000
	<hr/>
	\$24,877,490
	<hr/>

REQUIRED SUPPLEMENTARY INFORMATION
OTHER THAN MANAGEMENT'S DISCUSSION AND ANALYSIS

State of Hawaii
Department of Health

BUDGETARY COMPARISON SCHEDULE –
GENERAL FUND

Year ended June 30, 2003

	<u>Budgeted amounts</u>		<u>Actual amounts</u>
	<u>Original</u>	<u>Final</u>	<u>(budgetary basis)</u>
			<u>(see note A)</u>
Revenues			
Current-year appropriations	<u>\$ 359,446,015</u>	<u>\$ 333,635,487</u>	<u>\$ 318,588,629</u>
Total revenues	359,446,015	333,635,487	318,588,629
Expenditures			
General administration	14,703,672	10,165,058	15,326,591
Environmental health administration	14,732,549	16,678,377	15,956,453
Behavioral health services administration	185,308,130	157,162,375	146,092,801
Health resources administration	<u>144,701,664</u>	<u>149,629,677</u>	<u>141,212,784</u>
Total expenditures	<u>359,446,015</u>	<u>333,635,487</u>	<u>318,588,629</u>
EXCESS OF REVENUES			
OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

State of Hawaii
Department of Health

BUDGETARY COMPARISON SCHEDULE –
TOBACCO SETTLEMENT FUND

Year ended June 30, 2003

	<u>Budgeted amounts</u>		<u>Actual amounts</u>
	<u>Original</u>	<u>Final</u>	<u>(budgetary basis)</u>
			<u>(see note A)</u>
Revenues			
Current-year funds	<u>\$ 50,342,603</u>	<u>\$ 50,342,603</u>	<u>\$ 44,568,461</u>
Total revenues	50,342,603	50,342,603	44,568,461
Expenditures			
Health resources administration	<u>50,342,603</u>	<u>50,342,603</u>	<u>43,725,075</u>
Total expenditures	<u>50,342,603</u>	<u>50,342,603</u>	<u>43,725,075</u>
EXCESS OF REVENUE OVER EXPENDITURES	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 843,386</u></u>

State of Hawaii
Department of Health

BUDGETARY COMPARISON SCHEDULE –
BUDGET-TO-GAAP RECONCILIATION

Year ended June 30, 2003

NOTE A - Explanation of Differences between Budgetary Actual and GAAP Revenues
and Expenditures

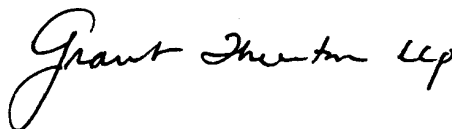
	<u>General Fund</u>	<u>Tobacco Settlement Fund</u>
Excess of revenues over expenditures and other sources and uses - actual on a budgetary basis	\$ -	\$ 843,386
Reserve for encumbrances at year end	39,492,554	10,455,938
Expenditures for liquidation of prior year's encumbrances	(64,765,923)	(11,768,087)
Accrual and other adjustments	<u>2,338,525</u>	<u>12,655,143</u>
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENDITURES AND OTHER SOURCES AND USES - US GAAP BASIS	<u><u>\$ (22,934,844)</u></u>	<u><u>\$ 12,186,380</u></u>

SUPPLEMENTARY INFORMATION

Report of Independent Certified Public Accountants
on Supplementary Information

Director of Health
Department of Health
State of Hawaii

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department of Health, State of Hawaii (Department), basic financial statements as of and for the year ended June 30, 2003, which are presented in the preceding section of this report. The supplementary information Schedule of Expenditures of Federal Awards, on pages 39 through 48 is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.



Honolulu, Hawaii
February 26, 2004

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
<u>Department of Health and Human Services (DHHS)</u>					
Direct Programs					
Bioterrorism Hospital Preparedness	435	93.003		\$ 310,113	\$ -
Special Programs for Aging – Title VII Chapter 3	401	93.041		19,127	
Special Programs for Aging – Title VII Chapter 2	401	93.042		46,641	
Special Programs for Aging – Title III Part B	401	93.044		1,954,554	
Special Programs for Aging – Title III Part C1	401	93.045		1,707,556	
Special Programs for Aging – Title III Part C2	401	93.045		879,104	
Special Programs for Aging – Title III Part D	401	93.046		102,095	
Special Programs for Aging – Title III Part E	401	93.043		675,162	
Special Programs for Aging – Title IV	405	93.048		171,615	
				<u>5,555,854</u>	
Hawaii Genetics Assessment and Planning Project	417	93.110A		26,048	
Genetics Services - State Development	425	93.110A		230,049	
Genetics Services	426	93.110A		323,676	
Integrated Comprehensive Women's Health Services in State MCH Program	282	93.110AK		45,738	
Healthy Child Care Hawaii	419	93.110AQ		95,533	
Maternal and Child Health Federal Consolidated Programs	307	93.110		113,805	
				<u>834,849</u>	12,927
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	247	93.116		1,120,933	-
Emergency Medical Services for Children System Enhancements and Partnership Grant	388	93.127C		138,491	
Primary Care Services – Resource Coordination and Development Primary Care Offices	298	93.130		179,760	-
Subtotal carried forward				\$ 8,140,000	\$ 12,927

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 8,140,000	\$ 12,927
Rape Prevention and Education	440	93.136		122,819	
Core State Injury Surveillance and Development	450	93.136		7,959	
Violence Against Women Planning	451	93.136		23,247	
Projects for Assistance in Transition from Homelessness (PATH)	14208	93.150		202,478	
	15208	93.150		107,025	
				<u>309,503</u>	167,263
Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children	215	93.197		100,684	-
Hansen's Disease National Ambulatory Care Program	264	93.215		1,739,623	
Family Planning – Services	239	93.217		1,466,318	665,811
Hawaii Youth Substance Abuse Prevention	421	93.230		1,917,781	295,139
Enhancement of the Data Infrastructure for the Mental Health Grants	430	93.230		31,665	
Traumatic Brain Injury	434	93.234A		36,824	
Abstinence Education Initiative	273	93.235		145,093	81,578
Enhanced Birth Defect Surveillance	276	93.238		134,500	
Hawaii State Infrastructure Program	455	93.238		32,289	
Rural Hospital Flexibility Program	415	93.241		295,652	
Subtotal carried forward				\$ 14,503,957	\$ 1,222,718

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 14,503,957	\$ 1,222,718
Implement Post Booking Jail	461	93.243		24,315	
Universal Newborn Hearing Screening	416	93.251		112,485	
TB Epidemiologic Studies Consortium	437	93.256		1,664	
State Planning Grant Proposal	439	93.256		598,060	146,581
Childhood Immunization Grants	269	93.268		1,781,113	
Immunization & Vaccines for Children	457	93.268		444,863	
Tobacco Prevention and Control Program	205	93.283		739,923	
Behavioral Risk Factor Surveillance System	202	93.283		75,855	
Hawaii DOPH for an Assessment of Health Effects Assoc. with Volcanic Emission	241	93.283		125,457	
Epidemiology and Laboratory Surveillance and Response	267	93.283		859,014	
Public Health Preparedness & Response for Bioterrorism	297	93.283		210,734	
Public Health Preparedness & Response for Bioterrorism	1297	93.283		3,329,025	
				<u>3,539,759</u>	
Pregnancy Risk Assessment Monitoring System	319	93.283		158,847	
Early Hearing Detection and Intervention Tracking Research	422	93.283		139,238	
Community Health Promotions	442	93.283		119,844	119,424
Addressing Asthma	444	93.283		60,287	
National Cancer Prevention & Control	448	93.283		291,230	
Subtotal carried forward				\$ 23,575,911	\$ 1,488,723

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 23,575,911	\$ 1,488,723
Small Rural Hospital Improvement	454	93.301		37,888	
Child Care and Development Block Grant	244	93.575		182,298	
Community-Based Family Resource and Support Grants	270	93.590		409,139	
Developmental Disabilities Basic Support and Advocacy Grants	240	93.630		429,139	
Po'ohala: To Carry on the Virtues and Skills of Family	420	93.631		50,233	
Family Support Demonstration	445	93.631		10,063	
Clinical Laboratory Improvement Amendments Program	380	93.777		85,152	
	221	93.777		1,237,606	
				<u>1,322,758</u>	
Health Care Financing Research, Demonstrations and Evaluations	403	93.779		120,700	
Grants to States for Operation of Offices of Rural Health	299	93.913		52,048	
HIV Care Formula Grants	293	93.917		2,956,255	
Comprehensive Breast & Cervical Cancer Early Detection Program	348	93.919		835,201	290,274
Healthy Start Phase II, Eliminating Racial / Ethnic Disparities	253	93.926E		999,621	110,761
Improving Women's Health for Depression	428	93.926L		142,565	
HIV Prevention Project	266	93.940		2,304,261	284,483
HIV/AIDS Surveillance and Seroprevalence Project	272	93.944		<u>168,811</u>	
Subtotal carried forward				\$ 33,596,891	\$ 2,174,241

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 33,596,891	\$ 2,174,241
Improving Contact Investigations in Foreign Born Populations	427	93.947		144,162	
Trauma - Emergency Medical Services	443	93.952		15,000	
Olmstead Financial Support Award	242	93.958		19,275	
Block Grants for Community Mental Health Services	20202	93.958		302,001	
	21202	93.958		1,294,296	
				<u>1,596,297</u>	156,110
Substance Abuse Prevention and Treatment Block Grant	20204	93.959		1,285,975	
	21204	93.959		6,257,608	
				<u>7,543,583</u>	5,629,883
Preventive Health Services – Sexually Transmitted Diseases Control Grants	268	93.977		431,556	
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	261	93.988		381,480	
Preventive Health and Health Services Block Grants	20203	93.991		453,506	
	21203	93.991		511,826	
	22203	93.991		321,191	
				<u>1,286,523</u>	64,161
Maternal and Child Health Services Block Grant	20201	93.994		17,518	
	21201	93.994		2,226,569	
				<u>2,244,087</u>	43,655
Hawaii Telemedicine Planning Initiative	206	15-50-96046		54,494	
Subtotal carried forward				\$ 47,313,348	\$ 8,068,050

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 47,313,348	\$ 8,068,050
Vital Statistics Cooperative Program	285	200-89-7211		116,166	
Demand and Needs Assessment – Alcohol and Other Drugs	372	277-98-6019		32,309	
Drug and Alcohol Services Information System	371	Not available		31,466	
Subtotal Direct Programs				47,493,289	8,068,050
Pass-through from the Commonwealth of Kentucky					
Medicare, Pacific Area	384	Not available		11,864	
Medicare, OASIS	387	Not available		7,582	
Subtotal Pass-through from the Commonwealth of Kentucky				19,446	
TOTAL DEPARTMENT OF HEALTH AND HUMAN SERVICES				47,512,735	8,068,050
<u>Department of Agriculture</u>					
Direct Program					
Special Supplemental Nutrition Program for Women, Infants, and Children	275	10.557		26,358,792	1,077,818
Nutrition Program for the Elderly	406	10.570		302,929	
Epidemiology Partnership Project with the Food Safety and Inspection Service	238	Not available		67,838	
TOTAL DEPARTMENT OF AGRICULTURE				26,729,559	1,077,818
<u>Environmental Protection Agency</u>					
Direct Programs					
Air Pollution Control Program Support	233	66.001		587,208	
Water Pollution Control – State and Interstate Program Support (Section 106 Grants)	231	66.419		1,341,961	
	237	66.419		91,012	
				1,432,973	
Subtotal carried forward				\$ 2,020,181	\$ -

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 2,020,181	\$ -
State Public Water System Supervision	232	66.432		437,829	
Water Quality Management Program	7284	66.454		61,089	
	8284	66.454		41,355	
	9284	66.454		44,539	
				<u>146,983</u>	16,851
Capitalization Grants for State Revolving Funds	4206 - 13206	66.458		49,330,430 (1)	11,279,753
Nonpoint Source Implementation Grants	3290	66.460		253,363	
	4289	66.460		53,380	
	5289	66.460		22,763	
	6289	66.460		380,328	
	7289	66.460		290,108	
				<u>999,942</u>	
Capitalization Grants for Drinking Water State Revolving Fund	1207-3207	66.468		3,120,921	2,202,868
Hardship Grant Program Rural Communities	227	66.470		109,400	
Beach Monitoring and Notification Program	431	66.472		18,871	
Water Protection Coordination	449	66.474		22,305	
Macroalgal Blooms	1236	66.606		11,452	
	2236	66.606		116,578	
				<u>128,030</u>	
Subtotal carried forward				\$ 56,334,892	\$ 13,499,472

(1) Includes loan balances of \$48,121,532 outstanding at June 30, 2003.

Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Subtotal brought forward				\$ 56,334,892	\$ 13,499,472
Clean Air Act	252	66.606		91,378	
PM 2.5 Monitoring Network	294	66.606		135,962	
CWA 104(b) (3) Statewide Public Participation	328	66.606		162	
Air Toxics Monitoring Project	429	66.606		5,329	
Water Infrastructure Oversight	460	66.606		2,859	
Toxic Substances Compliance Monitoring Cooperative Agreements	243	66.701		145,284	
State Lead Program	330	66.707		144,697	
Hazardous Waste Management State Program Support	230	66.801		537,546	
Preliminary Assessment/Site Inspection Program	249	66.802		145,338	
Kakaako Park Brownfields	228	66.802		25,708	
Super Fund Core Program	259	66.802		274,968	
	335	66.802		77,488	
				<u>352,456</u>	
State Underground Storage Tanks Program (UST Program)	220	66.804		137,034	
Leaking Underground Storage Tank (LUST) Trust Fund Program	258	66.805		395,016	
Model State Bottle Bill Project	289	66.808		3,069	
TOTAL ENVIRONMENTAL PROTECTION AGENCY				\$ 58,456,730	\$ 13,499,472

Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
<u>Department of Education (ED)</u>					
Pass through from the State Department of Education					
Grants for Infants and Toddlers With Disabilities	213	84.181		\$ 1,962,227	\$ 497,535
State Improvement Grant - Early Intervention	441	Not available		18,599	
TOTAL DEPARTMENT OF EDUCATION				1,980,826	497,535
<u>Department of Defense (DOD)</u>					
Direct Program					
Defense Environmental Restoration Program	245	12.113		119,126	
TOTAL DEPARTMENT OF DEFENSE				119,126	-
<u>Department of Justice (DOJ)</u>					
Direct Program					
FY 01 Enforcing Underage Drinking	438	16.727		324,496	33,231
FY 03 Enforcing Underage Drinking	458	16.727		2,884	-
TOTAL DEPARTMENT OF JUSTICE				327,380	33,231
<u>Department of Labor (DOL)</u>					
Direct Program					
State Legalization Impact Assistance Grant	201	Not available		401	
TOTAL DEPARTMENT OF LABOR				\$ 401	\$ -

State of Hawaii
Department of Health

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2003

Federal grantor/pass-through grantor/program title	Project number	CFDA, contract, award or assistance ID number	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
<u>Center for Disease Control</u>					
Pass through from the Association of Teachers of Preventive Medicine					
Breastfeeding Special Project	433	Not available		\$ 31,885	
TOTAL CENTER FOR DISEASE CONTROL				31,885	-
<u>Oregon Health and Science University</u>					
Direct Program					
Hawaii NFATTC	432	Not available		38,287	
TOTAL OREGON HEALTH AND SCIENCE UNIVERSITY				38,287	-
<u>Department of Transportation (DOT)</u>					
Pass through from the State Department of Transportation					
KIPC Oahu Program	Not available	20.600		106,888	
KIPC Big Island Project	Not available	20.600		44,500	
KIPC Kauai/KPD CPS Screening Project	Not available	20.600		21,000	
Child Passenger Protection Education Grant	Not available	20.600		12,520	
BAC Reporting Grant	Not available	20.600		19,500	
TOTAL DEPARTMENT OF TRANSPORTATION				204,408	
TOTAL FEDERAL FINANCIAL ASSISTANCE				<u>\$ 135,401,337</u>	<u>\$ 23,176,106</u>

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department of Health, State of Hawaii, and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

PART II
REPORTS ON COMPLIANCE AND INTERNAL CONTROL

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2003

Report on Compliance and on Internal Control
Over Financial Reporting Based on an
Audit of the Combined Financial Statements Performed in
Accordance with *Government Auditing Standards*

Director of Health
State of Hawaii

We have audited the financial statements of the Department of Health, State of Hawaii, as of and for the year ended June 30, 2003, and have issued our report thereon dated February 26, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department of Health, State of Hawaii's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including applicable provisions of Hawaii Public Procurement Code (Chapter 103D of Hawaii Revised Statutes) and Procurement Rules, Directives and Circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instance of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance, which we have reported to management of the Department of Health, State of Hawaii, in a separate letter dated February 26, 2004.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Health, State of Hawaii's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be

Director of Health
State of Hawaii

detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Department of Health, State of Hawaii, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Grant Huebner". The signature is written in a cursive, flowing style with a large initial 'G'.

Honolulu, Hawaii
February 26, 2004

Report on Compliance With Requirements Applicable
to Each Major Program and Internal Control Over
Compliance In Accordance With OMB Circular A-133

Director of Health
State of Hawaii

Compliance

We have audited the compliance of the Department of Health, State of Hawaii (Department), with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The Department's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 03-01 to 03-07.

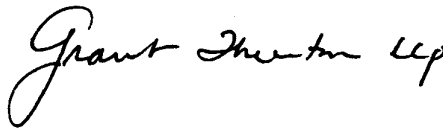
Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be significant deficiencies. Significant deficiencies involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Significant deficiencies are described in the accompanying schedule of findings and questioned costs as item 03-07.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 03-07 to be a material weakness.

This report is intended solely for the information and use of the Department and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Grant Thornton LLP". The signature is written in a cursive, flowing style.

Honolulu, Hawaii
February 26, 2004

PART III
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2003

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2003

Section I – Summary of Auditor’s Results

Our report dated March 30, 2003 on the combined financial statements of the Department of Health, State of Hawaii, as of and for the year ended June 30, 2003, contained a unqualified opinion.

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? ☐ yes ☒ No
- Reportable condition(s) identified that are not considered to be material weaknesses? ☐ yes ☒ none reported

Noncompliance material to financial statements noted? ☐ yes ☒ no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ☒ yes ☐ No
- Reportable condition(s) identified that are not considered to be material weakness(es)? ☐ yes ☒ none reported

Type of auditor’s report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?

☒ yes ☐ No

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2003

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
	U.S. Department of Health and Human Services
93.044/93.045	Special Program for the Aging – Title III Parts B and C
93.283	Centers for Disease Control and Prevention – Investigation and Technical Assistance
93.917	HIV Care Formula Grants
	U.S. Department of Agriculture
10.557	Special Supplemental Food Program for Women, Infants and Children
	U.S. Environmental Protection Agency
66.458	Capitalization Grants for State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Fund

Dollar threshold used to distinguish between type A and
type B programs:

\$3,000,000

Auditee qualified as low-risk auditee?

☐ Yes ☒ no

Section II – Financial Statement Findings

None noted.

Section III – Federal Award Findings and Questioned Cost

A. Special Programs for the Aging – Title III, Part B &C (CFDA 93.044 and 93.045)

1. Equipment Management

(Ref #03-01)

Per CFDA 93.044 and 93.045, equipment records shall be maintained and a physical inventory of equipment shall be taken at least once every 2 years and reconciled to the equipment records. During our testing of equipment, it was noted that the yearly physical inventory of equipment was

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2003

not reconciled to the “Annual Summary of Inventories Report” and the “Annual Summary of Inventories Report” has not been updated since 1995.

We recommend that the Department reevaluate its policies and procedures to ensure equipment records are prepared accurately and updated on a timely basis in the future.

2. Reporting

(Ref #03-02)

During our testing of the Federal Cash Transaction Reports (SF-272), it was noted that there was no supporting documentation for the SF-272 for the third quarter.

We recommend that the Department reevaluate its policies and procedures to ensure supporting documentation for the SF-272 reports are maintained for a period of two years in the future.

3. Subrecipient Monitoring

(Ref #03-03)

Per current Department policies, both on-site and fiscal assessments are done for each subrecipient on an annual basis. During our subrecipient monitoring testing, we noted that an annual assessment was not completed for one of the four subrecipients. The county was undergoing a reorganization and the Department was unable to complete the assessment on a timely basis.

We recommend that the annual on-site and fiscal assessment be performed for each county within six months of the end of the fiscal year.

B. Centers for Disease Control and Prevention-Investigations and Technical Assistance (CFDA 93.283)

1. Equipment Management

(Ref #03-04)

OMB Circular A133 states that a physical inventory of equipment shall be taken at least once every 2 years and reconciled to the equipment records. During our audit of the PHPRB program, we noted that an equipment inventory had not been taken for the past 2 years.

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2003

We recommend that the Department program follow state policies and procedures regarding equipment inventory and take a physical inventory on an annual basis.

C. Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468)

1. Binding Commitments

(Ref #03-05)

According to 40 CFR 35.3135(c), the State must make binding commitments in an amount equal to 120% of each quarterly grant payment within one year after the receipt of each quarterly grant payment. A grant payment is the EPA's action to increase the amount of capitalization grant funds available for cash draw. However, during our compliance testing, we noted that the State is not in compliance with this requirement. As of June 30, 2003, the State must have binding commitments in an amount of \$23,520,935, but only entered into commitments amounting to \$16,594,162.

We recommend that the state employ marketing strategies to inform the counties of resources available for eligible construction projects. This will help the State to fulfill their binding commitment requirement.

2. Equipment Management

(Ref #03-06)

The A-102 Common Rule requires that equipment records shall be maintained and a physical inventory of equipment shall be taken at least once every two years, and reconciled to the equipment records. During our equipment testing, we noted that equipment worth \$132,786 was not reported on the equipment records.

We recommend that the SDWB management ensure that fixed asset control policies and procedures are being followed and operating effectively.

3. Earmarking

(Ref #03-07)

In the case of State Program Management set-aside (40 CFR 35.3535(d)(2) and 35.550(h)), the State must provide an amount equal to 100% of the set-aside. The sources of these additional funds can be state monies or documentation of in-kind services. During our engagement, we

State of Hawaii
Department of Health

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2003

noted that the State does not keep track of its state monies to ensure that it is in compliance with the 1:1 State Program Management requirement. A budget is prepared to send to the EPA, however, actual State and Federal expenditures are combined and not differentiated.

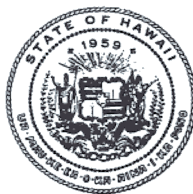
We recommend that the State segregate the State expenditures from the Federal expenditures to ensure that the State funds spent, or set-aside are equal to, or exceed the Federal Funds.

PART IV
RESPONSE OF THE AFFECTED AGENCY
(provided by Department of Health, State of Hawaii)

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2003

LINDA LINGLE
GOVERNOR OF HAWAII



CHIYOME L. FUKINO, M.D.
DIRECTOR OF HEALTH

**STATE OF HAWAII
DEPARTMENT OF HEALTH**

P.O. Box 3378
HONOLULU, HAWAII 96801-3378

March 24, 2004

In reply, please refer to:
File:

ASO-F-3097

Grant Thornton LLP
1132 Bishop Street, Suite 1000
Honolulu, HI 96813

Dear Grant Thornton:

Attached are the Department of Health's Correction Action Plan to the findings on the audit report for fiscal year 2003 and comments regarding prior year findings.

We appreciate the opportunity to comment on the audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "Chiyome Leinaala Fukino".

Handwritten initials in black ink, possibly "CLF".

CHIYOME LEINAALA FUKINO, M.D.
Director of Health

Attachment

A. Special Programs for the Aging – Title III, Part B & C (CFDA 93.044 and 93.045)

1. The yearly physical inventory of equipment was not reconciled to the “Annual Summary of Inventories Report” and the “Annual Summary of Inventories Report” has not been updated since 1995.

Corrective Action Plan

With the newly hired accountant, the Executive Office on Aging (EOA) was able to make a listing of acquisitions that are more than \$1,000.00 since 1998 and is in the process of submitting the form to add/reflect new acquisitions on the Detail Inventory of Property.

Presently, the EOA is in the process of identifying/locating the item on its Detail Inventory of Property after which the corresponding disposal form will be prepared to reflect the correction.

Currently, a procedure is in place to record new acquisition and disposal of inventory in a timely manner.

Person Responsible

Accountant

Anticipated Date of Completion

June 30, 2004

2. There was no supporting documentation for the SF-272 for the third quarter.

Corrective Action Plan

Systematic filing was instituted in order to avoid the same finding in the future.

Person Responsible

EOA Accountant

Anticipated Date of Completion

Completed.

3. The annual on-site fiscal assessment was not completed for one of the

four subrecipients. The subrecipient was undergoing a reorganization and the Department was unable to complete the assessment on a timely basis.

Corrective Action Plan

A team of three programmatic and fiscal staff will conduct an on-site and fiscal assessment on March 31, April 1 and 2, 2004 at the said subrecipient. Henceforth, an annual on-site and fiscal assessment of the subrecipients will be conducted by EOA within the period mandated.

Person Responsible

Programmatic and fiscal staff of EOA.

Anticipated Date of Completion

April 30, 2004

B. Centers for Disease Control and Prevention-Investigations and Technical Assistance (CFDA 93.283)

1. The Public Health Preparedness and Response for Bioterrorism Program has not been taking equipment inventory for the past two years.

Corrective Action Plan

The Public Health Preparedness and Response for Bioterrorism Cooperative Agreement (PHPRBCA) began in August, 1999 and comprised the following focus areas:

Focus Area A – Preparedness Planning and Readiness Assessment

Focus Area B1 & B2 – Surveillance and Epidemiology Capacity

Focus Area C – Laboratory Capacity – Biologic Agents

The total annual award from August 1999 to August 2001 ranged from \$600,000 to \$800,000. All fixed assets were inventoried under the applicable Division and annual wall-to-wall inventories were conducted. Focus Area A fell under the Communicable Disease Division, Focus Area B1 and B2 fell under the Epidemiology Branch and Focus Area C fell under the State Laboratory Division. However, in March 2002, the State received a \$7 million supplemental award that expanded the focus areas as follows:

Focus Area A – Preparedness Planning and Readiness Assessment
Focus Area B – Surveillance and Epidemiology Capacity
Focus Area C – Laboratory Capacity – Biologic Agents
Focus Area E – Health Alert Network/Training
Focus Area F – Communicating Health Risks and Health Information
Dissemination
Focus Area G – Education and Training

All efforts were focused on complying with the terms of the supplemental agreement and submitting required grant information and budget details for use of the funds. Once the supplemental budget was approved, the State then focused its efforts on establishing and filling the 35 new positions within the PHRBCA to manage the project. This process was cumbersome and resulting in significant hiring delays. A majority of the positions were not filled until the end of calendar year 2002. Once on board, the Bioterrorism (BT) staff was tasked with achieving the critical benchmarks required by the PHPRBCA. During this period, fixed assets were purchased and should have been inventoried. However, with the expansion of Focus Areas now involving two divisions and three offices and all islands, it was unclear as to the appropriate method to track the inventory. In addition to this, the Disease Outbreak Control Division took over the management of Focus Area A and B from the Communicable Disease Division. Therefore, inventory control, which is recognized as an important administrative task, was left undone until such time as the programmatic aspects of the PHPRBCA were under control and a procedure could be implemented that would comply with State policies and procedures.

BT organization codes are now established to track inventory and the process of transferring all fixed assets purchased with PHPRBCA funds to the appropriate organization code has started to ensure that all future fixed asset purchased are inventoried on a timely basis. A wall-to-wall inventory will be completed by the end of calendar year 2004.

Person Responsible

BT Accountant

Anticipated Date of Completion

December 31, 2004

C. **Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468)**

1. As of June 30, 2003, the State must have binding commitments in an amount of \$23,520,935, but only entered into commitments amounting to \$16,594,162.

Corrective Action Plan

The Drinking Water State Revolving Fund (DWSRF) staff has been working with the Honolulu Board of Water Supply (BWS), the State's largest water supplier to make use of DWSRF loan monies. After significant effort, the BWS has decided to use DWSRF loans for several large projects. We believe that with the BWS on board as a customer, there should be no problem meeting our binding commitment requirement. In addition, we will be pursuing the establishment of a private loan program.

Person Responsible

Chief, Safe Drinking Water Branch

Anticipated Date of Completion

September 30, 2004

2. Significant equipment worth \$132,786 was not reported on the equipment records.

Corrective Action Plan

The Safe Drinking Water Branch has been working with the State Laboratories Division to properly inventory pieces of equipment purchased with DWSRF set-aside funds. While apparently an understanding had been reached with respect to purchases made through purchase orders, some confusion remained with purchase accomplished through contracts. The \$132,786 worth of equipment not on inventory represents two pieces of equipment purchased through contracts. We will continue to work with the State Laboratory Division to make sure that the proper documents are submitted to the Safe Drinking Water Branch for all equipment purchases.

Persons Responsible

Chief, Safe Drinking Water Branch

Chief, Environmental Health Analytical Services Branch

Anticipated Date of Completion

July 31, 2004

3. The State does not keep track of its state monies to ensure that it is in compliance with the 1:1 State Program Management requirement. A budget is prepared to send to the EPA, however, actual State and Federal expenditures are combined and not differentiated.

Corrective Action Plan

The Safe Drinking Water Branch will work with the Department's Administrative Services Office to develop an acceptable means of tracking all state funds expended as match for the SRF 10% set-aside. These funds include both general funds and revolving funds (ERRF).

Persons Responsible

Chief, Safe Drinking Water Branch

Anticipated Date of Completion

October 31, 2004

PART V
COMMENTS REGARDING PRIOR FISCAL YEAR FINDINGS
(provided by Department of Health, State of Hawaii)

STATE OF HAWAII
DEPARTMENT OF HEALTH

June 30, 2003

COMMENTS REGARDING PRIOR FISCAL YEAR FINDINGS

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

A. HIV Care Formula Grants (CFDA 93.917)

1. Reporting (Ref #02-01)

The auditors recommended that the State stress the importance of the reporting standards in their training of all new personnel.

Status

Completed

Reporting (Ref #02-02)

The auditors recommended that proper steps be taken to ensure that reports are submitted in a timely manner.

Status

Completed

2. Maintenance of Effort (Ref #02-03)

The auditors recommended that the State implement policies and procedures to ensure that the staff properly adheres to the reporting requirements as prescribed in the Ryan White CARE Act Grant Application Guidance and the OMB A-133 Compliance Supplement.

Status

Completed

B. Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468)

Environmental Review (Ref #02-04)

The auditors recommended that all forms be correctly completed before they are placed in the project files and that project files be maintained on a timely basis.

Status

Completed

C. Special Programs for the Aging – Title III, Part B & C (CFDA 93.044 and 93.045)

The auditors recommended that Department personnel responsible for preparing the Financial Status Reports take appropriate measures to ensure that the information provided in these reports are accurate.

Status

Completed